Memorandum

Montana Department of LABOR & INDUSTRY

TO: Adam Schafer, Office of the Governor
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DATE: February 20, 2018
SUBJECT: Local tax impacts of Colstrip Units 1&2 Closures

As you know, Colstrip Units 1&2 are required to close by 2022 under a legal settlement. This closure will impact the county, city, and school district finances. This memorandum provides background information on the local funding impacts of the closure of units 1&2, using information available from the Montana Department of Revenue and the Legislative Branch.

There are several tax revenue sources that will impact the state's budget, but that will not directly affect the local governments in Rosebud County. These state revenue impacts include receipts from the coal severance tax, resource indemnity trust and ground water assessment tax, individual and corporate income taxes, electrical energy producer's license tax, and wholesale energy generation tax. These revenue sources are not discussed in this memorandum, but the attachments from the Montana Legislative Branch both provide additional information about the size of these revenues and estimated state-level impacts from the Colstrip Units 1&2 closure. The state is also impacted by the loss of revenue from the three revenue sources discussed in this memo (U.S. mineral royalties, coal gross proceeds, and property tax), but the state impacts are not the focus. This memorandum only discusses revenue sources with direct impacts to local jurisdictions.

The revenue impact varies depending on assumptions regarding the distribution of value within each of the four units at the Colstrip power plant. The total taxable value for the Colstrip plant, including all property within Rosebud County that is owned by the Colstrip owners, was $75.9 million in tax year (TY) 2017.[1] Estimates developed by the Legislative Fiscal Division assumed that 29% of the Colstrip plant's taxable value would be lost with the closure of 1&2, basing that assumption on the generating capacity.[2] Estimates developed by the Montana Department of Revenue assumed that units 1&2 each contained 14.7% of the taxable value of the plant, or 29.4% of the total plant.[3] This memorandum continues the assumption that 29.4% of the taxable value falls within units 1&2, but it's difficult to know the exact impact on the power plant's taxable value.

The three main sources of local revenues affected by the closure of units 1&2 are local share of U.S. mineral royalties, coal gross proceeds taxes, and property tax.

U.S. Mineral Royalties-

The federal government collects royalties on every ton of coal mined on federal lands. Roughly 49% of royalties collected from federal lands in Montana are re-distributed back to the state. The majority of the state's share of the royalties go to the general fund, but 25% are deposited into a mineral impact account for local governments.

[1] Montana Department of Revenue in email conversation with Rose Bender, Tax Policy Analyst.
[2] See attached memo from Nick VanBrown and Sam Schaefer, Legislative Fiscal Division, to Senator Duane Ankney, June 2016.
[3] See attached memo from Montana Department of Revenue written by Rose Bender, Feb. 2018.

The Department of Revenue indicates Rosebud County received $1.7 million from federal mineral royalties in FY2016.[4]

Data collected by the Energy Information Administration (EIA) indicates that units 1&2 used roughly 2,318,000 short tons in 2016, or about 27% of the total production at the Rosebud mine.[5] Using this assumption, the closure of units 1&2 may decrease U.S. Mineral Royalty distributions to Rosebud County by 27%, or about $459,485 in FY2016. However, 2016 coal production was relatively low, and coal production forecasts suggest an increase in production levels from the 2016 lows.[6] Units 3&4 may need to increase their coal consumption to continue to meet power demand, thus countering the loss of coal demand from the Units 1&2 closure. Any growth in coal production for use in Units 3&4 (or other customers) will help offset the revenue losses from the closure of Units 1&2.

Coal Gross Proceeds-

A 5% annual flat tax is levied on the reported gross proceeds of coal mines, then distributed to both the state general fund and to local jurisdictions with coal production. The amount of revenue redistributed back to local jurisdictions depends on the production and number of mills levied in 1990. For example, if the city mills comprised 15% of total mills levied in 1990, 15% of the coal gross proceeds tax collected from production in Rosebud County should be transferred to the city.

Like the federal mineral royalty distributions, the closure of Units 1&2 would affect the coal gross proceeds revenues because of lower demand and production at the Rosebud mine. In FY2016, Rosebud County received $3.286 million from coal gross proceeds taxes, which was distributed across different taxing jurisdictions. If we assume that the value of coal mined at the Rosebud mine decreases by 27% due to the Units 1&2 closure, that would have resulted in a loss of $887,300 in FY2016. However, as mentioned above, coal prices are expected to increase through 2022 due to increased market demand. As coal prices increase, the gross proceeds tax base will grow, minimizing the impact of the Units 1&2 closure. Further, it is possible that coal demand from the remaining two units will help counter the loss in demand from Units 1&2.

Property Tax-

In TY2017, Rosebud County had $94.7 million in taxable value for property taxes, according to the Montana Department of Revenue.[7] The total taxable value for the Colstrip plant, including all property within Rosebud County that is owned by the Colstrip owners, was $75.9 million in tax year (TY) 2017, or about 80% of the taxable value in the county. According to the same source, Units 1&2 comprise $22,307,814 of that taxable value, or roughly 24% of the total taxable value in the county. The attached memo from Rose Bender at the Montana Department of Revenue elaborates on the impact of the Units 1&2 closure, indicating that the estimated loss of property tax is roughly $6.58 million using TY2017 values. Assuming the loss of taxable value

[4] Montana Department of Revenue. "2014-2016 Biennial Report" available at https://mtrevenue.gov/publications/biennial-reports page 356.

[5] Energy Information Administration. Form EIA-923 detailed data. Available at https://www.eia.gov/electricity/data/eia923/.

[6] Energy Information Administration. Annual Energy Outlook. Coal Production Forecasts without the Clean Power Plan. Available at www.eia.gov/coal.

[7] Montana Department of Revenue. TY2017 Rosebud County Assessed and Taxable Value, Mills, and Revenue.

occurs in the same levy district as the plant (levy district 29-3796), the following taxing jurisdictions will experience a loss of taxable value equal to $22.3 million in TY2017 values:

Taxing Jurisdictions Impacted by Closure of Units 1&2 (TY2017 Values)				
Tax Jurisdiction	**Unit Code**	**Existing Taxable Value (TY2017)**	**Taxable Value after Closure (in TY2017 Values)**	**Percent Decline**
CITY OF COLSTRIP	29-COLSTRI	60,699,201	38,391,387	-36.8%
COLSTRIP ELEMENTARY	29-0796	83,478,458	61,170,644	-26.7%
COLSTRIP HIGH SCHOOL	29-0797	83,478,458	61,170,644	-26.7%
COLSTRIP MEDICAL	29-COLMED	80,627,190	58,319,376	-27.7%
COLSTRIP PARK	29-COLPARK	80,627,190	58,319,376	-27.7%
COUNTY WIDE CEMETERY	29-CNTYWID	94,694,598	72,386,784	-23.6%
COUNTY WIDE FUNDS	29-CNTYWID	94,694,598	72,386,784	-23.6%
COUNTY WIDE SCHOOL LEVIES	29-CTYSCHL	94,694,598	72,386,784	-23.6%
Specials from County TLR	29-OTHER	94,694,598	72,386,784	-23.6%
Source: Worksheet provided by Montana Department of Revenue, compiled by Montana Department of Labor & Industry				

The above losses in taxable value would have substantial impacts on local revenues if mills were not allowed to adjust. However, Montana laws governing property tax assessment allow local mills to "float," or automatically adjust to keep tax revenues relatively level to the prior year. While the purpose of the mill float is to limit the growth of property tax at the local level, the mill float will also allow taxing jurisdictions to automatically increase mills (rather than receiving voter approval on a mill levy). The applicable law can be found in Montana Code Annotated 15-10-420, with section 1(a) reprinted here:[8]

> *15-10-420. Procedure for calculating levy. (1) (a) Subject to the provisions of this section, a governmental entity that is authorized to impose mills may impose a mill levy sufficient to generate the amount of property taxes actually assessed in the prior year plus one-half of the average rate of inflation for the prior 3 years. The maximum number of mills that a governmental entity may impose is established by calculating the number of mills required to generate the amount of property tax actually assessed in the governmental unit in the prior year based on the current year taxable value, less the current year's newly taxable value, plus one-half of the average rate of inflation for the prior 3 years.*

If local jurisdictions choose to maintain level revenues from the prior year and allow mills to float in response to the closure, the mills in all affected taxing units will increase, thus increasing the taxes on all other property owners. The increase in mills required to keep revenues level is shown in Table 2 below. This calculation uses the existing mill levies from TY2017 and assumes that the impact of the Units 1&2

[8] For more information on the limitation on property tax revenues in MCA, 15-10-420, see the Montana Department of Revenue's biennial report.

closure happens all in one year. The mills from the special levy districts and the state levy are excluded from Table 2 because the majority of these mills would not float.

Table 2: Change in Mills Required to Keep Level Revenues with Closure of Units 1&2					
Tax Jurisdiction	**Unit Code**	**TY2017 Mills**	**After Closure Mills**	**Increase in Mills**	**Tax Revenues (both before and after)**
CITY OF COLSTRIP	29-COLSTRI	47.60	75.26	27.66	2,889,281.97
COLSTRIP ELEMENTARY	29-0796	21.10	28.79	7.69	1,761,395.46
COLSTRIP HIGH SCHOOL	29-0797	16.32	22.27	5.95	1,362,368.43
COLSTRIP MEDICAL	29-COLMED	8.60	11.89	3.29	693,393.83
COLSTRIP PARK	29-COLPARK	21.97	30.37	8.40	1,771,379.36
COUNTY WIDE CEMETERY	29-CNTYWID	0.35	0.46	0.11	33,143.11
COUNTY WIDE FUNDS	29-CNTYWID	43.85	57.37	13.51	4,152,642.21
COUNTY WIDE SCHOOL LEVIES	29-CTYSCHL	12.63	16.52	3.89	1,195,992.77
Total		***172.42***	***242.94***	***70.51***	
Source: Worksheet provided by Montana Department of Revenue, compiled by Montana Department of Labor & Industry					

In other words, if local officials chose to allow all mills to float, a homeowner taxed by all levies listed would experience an increase of 70.51 mills. While the 70.51 mill increase is sizeable in comparison to the existing mill amount, it may still be manageable by property owners. The resulting mill levy of 242.94 is still far below the 573.83 average mills across all jurisdictions in Montana (TY2016). Table 3 below illustrates the increase in taxes due on hypothetical properties in classes 3 and 4. For agricultural land valued at $1 million, the 70.51 mill increase would raise taxes by $1,523 annually. For a residential single-family home valued at $150,000, the impact would be about $143 per year. Finally, for a hypothetical commercial building valued at $1,000,000, the tax increase from 70.51 mills would be about $1,333 annually.

Table 3: Hypothetical Impact of 70.51 Mill Increase on Taxes for Property of Different Classes			
	Market Value	**Taxable Value**	**Tax Increase**
Class 3: Agricultural Land	500,000	10,800	$762
	1,000,000	21,600	$1,523
Class 4: Residential Property	100,000	1,350	$95
	150,000	2,025	$143
	200,000	2,700	$190
Class 4: Commercial Property	500,000	9,450	$666
	1,000,000	18,900	$1,333

How Reliable are These Estimates?

All forecasts are based on assumptions and existing knowledge of future possibilities. If the assumptions or knowledge change, so will the tax impacts. The assumption that Units 1&2 hold $22.3 million in taxable value was based on the share of generation coming from each unit. Units 1&2 could be worth less or more than $22.3 million in taxable value. Further, the above calculation of property tax impacts assumes that no other investments are made to counter that loss of taxable value. For example, with the closure of Units 1&2, Units 3&4 may increase generation to meet energy demands. The increase in generation would require additional coal, thus increasing mineral royalties and gross proceeds taxes. The increase in generation may also increase the valuation of Units 3&4 because they are producing more income with the units.

In addition, the remediation of the Colstrip property will likely add some value in upcoming years. The Class 8 business equipment currently used at the power-plant site may be repurposed in remediation and cleanup activities, reducing the loss of taxable value. Increases in pollution controls could increase the amount of Class 5 property, further mitigating the impacts.

Finally, any new investments in Rosebud County would add to the tax base, allowing the local jurisdictions to raise similar revenues with a lower mill increase. As the community moves forward with planning profitable investments, the valuation of new developments should be an important consideration in prioritizing projects.

Mill Shift Tool

To assist the community of Colstrip understand the impacts of various investments on mill rates, the Montana Department of Revenue will provide a Mill Shift Estimation tool that is pre-loaded with data for Rosebud County. This spreadsheet allows the user to enter an estimated increase (or decrease) in taxable value from proposed projects, then the tool will automatically calculate the impact on mills for each taxing jurisdiction. This tool can be obtained by contacting Barbara Wagner at bwagner@mt.gov, or Rose Bender at rbender@mt.gov. The tool should be helpful to local officials and economic development professionals wanting to evaluate the impact of various investments on local tax revenues.

Attachments:

1. Bender, Rose. Montana Department of Revenue. Memo to Director Kadas dated February 6, 2018.
2. Montana Department of Revenue. Rosebud County Taxable Value, Mills and Taxes for TY2017.
3. Nowakowski, Sonja. "Senate Joint Resolution 5: Coal in Montana; Fiscal Impacts" report produced for the Environmental Quality Control Interim Committee, Montana State Legislature. Jan. 17, 2018. Available at http://leg.mt.gov/content/Committees/Interim/2017-2018/EQC/Meetings/Jan-2018/sj-5-coaltaximpacts.pdf.
4. VanBrown, Nick and Schaefer, Sam. Montana Legislative Branch. Memo to Senator Duane Ankney dated June 17, 2016.